No. 18819

# United States
# Court of Appeals
## for the Ninth Circuit

PHOENIX TITLE & TRUST COMPANY — Appellant

vs.

ARTHUR PEABODY AND
OLIVE PEABODY — Appellee

On Appeal from the United States District Court
for the District of Arizona

# Brief for Appellant

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### JURISDICTIONAL STATEMENT

This is an appeal from an Order on Review of the District Court of Arizona entered on March 29, 1963, sustaining the Findings of Fact I, II, III and IV and Conclusions of Law 1, 2, 3, 7, 8, 16 and 17 of the Referee in Bankruptcy dated May 31, 1962, and a Turnover Order of the same date.

The District Court had jurisdiction by virtue of a Petition for Review filed by the Appellant June 11, 1962 under the provisions of Title 11 Bankruptcy Sec. 11 a(10) United States Code and the Referree in Bankruptcy had jurisdiction by virtue of a Petition for Determination of Custody and Possession of Assets and for Turnover Order filed by Trustee in Bankruptcy of Arthur Peabody and Olive Peabody, husband and wife, dated August 18, 1960, and Petition for the Determina-

tion of Priority Among Creditors and Permission for Phoenix Title & Trust Company to Control Trust Property in Accordance With Trust Agreement Subject Only to Priority Rights of Creditors as Established by Referee filed September 23, 1960, under the provisions of Title 11 Bankruptcy Sec. 11 a(7) United States Code.

Pleadings which show the existence of jurisdiction are Petition for Involuntary Bankruptcy (TR 1), Petition for Determination of Custody and Possession of Assets and for Turnover Order (TR 63) and Petition for the Determination of Priority Among Creditors and Permission for Phoenix Title & Trust Company to Control Trust Property in Accordance With Trust Agreements Subject Only to Priority Rights of Creditors as Established by Referee (TR 66). The position of Phoenix Title was that it had title and right to possession of the assets in question, was an adverse claimant to the Trustee in Bankruptcy, but that the Referee in Bankruptcy had the right, power and jurisdiction to have a hearing to determine if he had jurisdiction over the specific assets in question. (RT 12-1-60 pg. 5, 27).

## STATEMENT OF THE CASE

### A. FACTUAL BACKGROUND

This is a proceedings to establish the validity of a security interest of Phoenix Title and Trust Company in and to specified property and to determine if, by virtue of the legal device used, the rights of Phoenix Title and Trust Company are prior to those of the Trustee in Bankruptcy.

Arthur Peabody and Olive Peabody, husband and wife, on July 26, 1956, executed and delivered to and with Phoenix Title and Trust Company, an Arizona

corporation, a Trust Deed, dated July 23, 1956, (22,30)* a Trust Agreement known as No. 6007, dated July 23, 1956, (30,32) a Note for $50,000.00 dated July 24, 1956, payable to Phoenix Title and Trust Company (31,32), and a Collateral Assignment of Beneficial Interest in Trust 6007 and other assets of the Peabodys as security for the payment of the $50,000.00 Note (31,32) all as one complete transaction.

Financial difficulties developed for the Peabodys as a result of loss of a contractor's license and the condemnation of a portion of a shopping center on the trust property, but by that time through the sale of various parts of the trust assets or the assets collaterally assigned, the principal balance of the Note had been reduced to $42,536.24, together with interest from October 1, 1957 (TR 48 & 62).

Phoenix Title, as Trustee, assumed responsibility in connection with the condemnation suit under written agreements and as a result a $22,200.00 judgment was obtained and the State of Arizona paid a total of $26,093.82 to settle this judgment (39). From the date of the State of Arizona taking possession of the condemned portion of the premises, namely, June 1, 1957, to date, Phoenix Title and Trust Company has been in exclusive possession of the trust property (TR 72).

On December 12, 1958, Phoenix Title and Trust Company filed a suit to foreclose their mortgage lien (Collateral Assignment of Beneficial Interest) and continued that action until enjoined from further proceedings by the District Court on January 28, 1960 (Rep. Tr. 1-28-60) (TR 184).

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* Numbers refer to pages in Reporter's Transcript of Proceedings of December 1, 1960.

A petition for involuntary bankruptcy was filed by other creditors (TR 1) and the Peabodys were adjudged bankrupt effective April 15, 1959 (TR 16).

A brief, chronological list of the events that affect the issues in this matter is as follows:

| *Exhibit* | *Creditor* | *Lien* | *Date* | *Amount* |
|---|---|---|---|---|
| | Peabody had title on 7-22-56 and before[1] (Note)* | | | |
| 1. | Midway Lumber Co. | Mechanics Lien | 12-18-56[2] | $ 2,415.76+ |
| 2. | Phoenix Title | Trust Deed | 7-31-56[3] | |
| 3. | " | Trust Agreement | 7-31-56[4] | |
| 4. | " | Note | 7-31-56[5] | $42,536.24+ |
| 5. | " | Collateral Assign-ment | 7-31-56[6] | |
| 6. | Tucson News-papers, Inc. | Judgment | 2-18-57[7] | $ 1,000.00+ |
| 7. | Midway Lumber | Judgment | 2-19-57[8] | |
| 8. | Condemnation Action filed Feb. 28. 1957[9] | | | |
| 9. | Luella Don | Judgment | 4-26-57[10] | $ 1,250.00+ |
| 10. | Michael Melynkovich | Judgment | 6-3-51[11] | $10,668.23+ |
| 11. | Midway Lumber | Lis Pendens | 6-5-57[12] | |

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* Note all references are to Rep. Tran. 12-1-60

[1] Page 20, 21, 30, 33.
[2] Page 20, 21, 33.
[3] Page 22, 30.
[4] Page 30, 32.
[5] Page 31, 32.
[6] Page 31, 32.
[7] Page 34, 35.
[8] Page 35, 36.
[9] Page 36.
[10] Page 37.
[11] Page 37.
[12] Page 37.

| *Exhibit* | *Creditor* | *Lien* | *Date* | *Amount* |
|---|---|---|---|---|
| 12. & 13. | Johnson | Deed & Assignment, etc. | 6-21-57[13] | |
| 14. | Amer. Radiator & Standard Sanitary Corp. | Assignment condemnation proceeds and interest in trust | 7-31-57[14] | $ 2,072.00+ |
| 15. | Midway Lumber | Assignment, etc. | 7-31-57[15] | $ 1,158.03+ |
| 16. | A. R. Garrett | Assignment, etc. | 7-31-57[16] | $ 1,108.68+ |
| 27. | United States | Tax Lien | 8-28-57[17] | $ 4,268.21+ |
| 17. | Jack Henry | Judgment | 9-7-57[18] | $ 2,027.31+ |
| 18. | Herman J. Goldstein | Judgment | 9-17-57[19] | $ 575.00+ |
| 28. | United States | Tax Lien | 9-21-57[20] | $ 2,076.67+ |
| 19. | Lohse, Donahue & Bloom | Attorney's Lien | 10-31-57[21] | $ 3,625.50+ |
| 20. | Employment Security Commission of Arizona | Tax Lien | 11-21-57[22] | $ 83.31 |
| 21. | Jackie C. Stewart | Judgment | 12-3-57[23] | $ 3,685.40+ |

[13] Page 37, 38.
[14] Page 38.
[15] Page 38.
[16] Page 38, 39.
[17] Page 41.
[18] Page 39.
[19] Page 39.
[20] Page 41.
[21] Page 39.
[22] Page 39, 40.
[23] Page 40.

| *Exhibit* | *Creditor* | *Lien* | *Date* | *Amount* |
|---|---|---|---|---|
| 22. | Employee's Liability Assurance Co. Ltd. | Judgment | 1-20-58[24] | $ 2,200.00+ |
| 23. | Builder's Mortgage & Trust Co. | Judgment | 1-25-58[25] | $ 4,841.80+ |
| 24. | Builder's Mortgage & Trust Co. | Judgment | 1-25-58[26] | $ 4,841.80+ |
| 25. | Edwin W. Smalley | Judgment | 4-15-58[27] | $ 9,898.00+ |
| 26. | William T. Fitchett | Judgment | 4-15-58[28] | $ 2,085.04+ |

Most of the creditors having secured a judgment against the Peabodys also have taken assignments of rights to the condemnation money and in some cases an actual assignment of the beneficial interest in trust of the Peabodys (38).

Notwithstanding the fact that record title to all assets was in Phoenix Title and Trust Company, no creditor ever claimed that he had made any investigation as to the terms and conditions of the trust, the ownership of the beneficial interest or any other point in connection therewith, it being conceded that no investigation was in fact made by anyone.

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[24] Page 40.
[25] Page 40.
[26] Page 40.
[27] Page 41.
[28] Page 41.

With reference to the money secured by the condemnation judgment, Lohse, Donahue & Bloom claim and allege an Attorney's Lien as the first claim. This position was sustained by the Referee and District Judge and is not under appeal. The superior position of Midway Lumber under their Mechanics Lien has also been resolved and will be paid by stipulation from the condemnation money.

On August 18, 1960, Myles C. Stewart, the Trustee in Bankruptcy, filed a Petition for Determination of Custody and Possession of Assets and for Turnover Order with reference to the condemnation proceeds (TR 63). Phoenix Title and Trust Company, without every submitting to the jurisdiction of the Bankruptcy Court, but at all times recognizing and stipulating that the Bankruptcy Court had jurisdiction to hold a hearing to determine if it had authority to sign a Turnover Order, on September 23, 1960, filed a petition with the Bankruptcy Court alleging rights to the condemnation proceeds and asking that its rights to these proceeds be established (refuse turnover order), that the trust continue in accordance with its terms, that the order of priority of creditors be established and that the Title Company be authorized to pay those creditors and the then balance, if any, be paid to the Trustee in Bankruptcy (TR 66).

At the pre-trial meeting, a stipulation admitted into evidence all exhibits indicated above, and it is from these documents that the rights of all parties are based (41,42). The key instruments in this case have several different exhibit designations at various times, but the following designations used for the greater part of the time refer to the same instruments:

| | Pre-Trial | | |
|---|---|---|---|
| Trust Deed | 2 | or | 1 |
| Trust Agreement | 3 | or | 1B |
| Note | 4 | or | 1C |
| Collateral Assignment | 5 | or | 1D |

Finding of Fact and Conclusions of Law and a Turnover Order were issued by the Referee in Bankruptcy May 31, 1962 (TR 123, 138, 158). The Trustee in Bankruptcy petitioned the District Court for Review as to Conclusions of Law 14 and 15 and for failure to decide an issue under Sec. 70 (c) of the Bankruptcy Act (TR 141). Phoenix Title and Trust Company petitioned with reference to Findings of Fact I, II, III, IV and Conclusions of Law 1, 2, 3, 7, 8 (9), (10), 11, 13, 16 and 17 and the Turnover Order (TR 143). The District Court, on March 29, 1963, reversed the Referee on Conclusions of Law 11 and 13 and sustained all other points (TR 171), ruling that this was a passive trust and therefore void, the Collateral Assignment is an unrecorded mortgage voidable under Sec. 70(c) of the Bankruptcy Act or that it was an unfiled mortgage of personal property void under Arizona law.

## B. LEGAL BACKGROUND

Under Arizona law, Phoenix Title and Trust Company has a security interest in the nature of a mortgage on real property which the Trustee in Bankruptcy claims. The security interest claimed vested long before the 4 month period concerning preferential treatment to creditors commenced. Bankruptcy Act § 3(a)(2); 11 USCA § 21(a)(2); 11 FCA Title 11, § 21(a)(2). The validity of the lien of Phoenix Title and Trust Company is determined by Arizona law as distinct from Federal law.

## SPECIFICATIONS OF ERRORS RELIED ON

The District Court erred in sustaining the Referee in Bankruptcy's Findings of Fact II, III, and IV (pages 125 and 126 of the (Record) and Conclusions of Law 1, 2, 3, 7, 8 (pages 132 and 133 of the Record) and 16 and 17 (page 135 of the Record) as a result of which findings of fact and conclusions of law the District Court:

1. Failed to construe the Trust Deed, Trust Agreement, Promissory Note and Collateral Assignment together as collectively constituting a security device in the nature of a mortgage.

2. Failed to construe the instruments listed in paragraph 1 together so that the active duties of the Trustee under the Collateral Assignment were disregarded and the trust found to be a passive trust executed by the Statute of Uses.

3. Erred in construing the Trust Deed and Trust Agreement as not creating an active trust even if the District Court was correct in failing to construe the Promissory Note and Collateral Assignment as part of the same transaction.

4. Erred in failing to apply the doctrine of *Barringer v. Lilly,* Cir 9, 96 F.2d 607, as it applies to the creation of a security devise and the giving of notice by the recorded Trust Deed thereby perfecting the lien of Phoenix Title and Trust Company against all subsequently recorded liens.

## QUESTIONS PRESENTED

1. Whether it is necessary to construe all the documents mentioned in the Specification of Errors together in order

(a) To determine if the lien of Phoenix Title and and Trust is a valid recorded lien prior in time to the liens of all creditors of Arthur Peabody, except Midway Lumber Company; and

(b) To determine if the trust created was passive and thereby executed under the Statute of Uses.

2. Whether — if the documents mentioned in the Specifications of Errors need not be construed together — the trust created by the Trust Deed and Trust Agreement alone was passive and thereby executed under the Statute of Uses.

3. Whether — if the documents mentioned in the Specifications of Errors need not be construed together — the trust created by the Deed, Trust Agreement, and the Promissory Note and Collateral Assignment was not, because of the recorded Trust Deed, a valid lien prior in time to the liens of all creditors of Arthur Peabody except Midway Lumber Company notwithstanding the trust so created was a passive trust.

## ARGUMENT

### A. SUMMARY OF ARGUMENT

In effecting its lien against the property subject to this appeal, Phoenix Title and Trust Company caused four instruments to be executed by the bankrupts, Arthur Peabody and wife, all of which were executed on the same day, to-wit: July 26, 1956, as part of the same transaction and covering the same subject matter. The instruments executed that day constituting

the security of Phoenix Title and Trust Company for the advancement of $50,000.00 were collectively intended as a mortgage by the parties. The Trust Deed which was recorded constituted notice of the existence of a trust to all the world including possible bona fide purchasers and of the Trustee's power to make sales and conveyances. The Trust Agreement was the vehicle by which sales could be made of the trust property in order to provide the funding for the payment of the Promissory Note secured by the Collateral Assignment. The duties of the Trustee in enforcing the security created by this package of instruments were active duties, and the lien of Phoenix Title and Trust created thereby was, as of the date of the recording the Trust Deed, to-wit: July 31, 1956, good against all subsequent creditors under the doctrine of *Barringer v. Lilly,* 9 cir. 96 F.2d 607, in that any potential creditor of the bankrupts would be charged with knowledge of the terms of the Trust Deed and of the existence of the trust and if inquiry were pursued would have discovered the existence of the package constituting the terms of Phoenix Title and Trust Company's lien. Even if the instruments are not construed together and the Trust Deed and Trust Agreement are construed separately from the Collateral Assignment and Promissory Note secured thereby, the Trust Agreement is active by its terms and was in fact actively operated as of the date of bankruptcy. Finally, irrespective of any issue of active or passive trust, the lien of Phoenix Title and Trust Company was good as of July 31, 1956, against all subsequent creditors under the doctrine of *Barringer v. Lilly supra* in that record title was in Phoenix Title and Trust Company as Trustee, so that regardless of the legal efficacy of the other instruments concerned with the creation of

the lien, the record title in Phoenix Title and Trust Company as Trustee estops any potential bona fide creditor purchaser from assertitng a subsequently recorded lien.

## B. NECESSITY TO CONSTRUE INSTRUMENTS CREATING LIEN TOGETHER

The critical instruments involved in this appeal are a Trust Deed (Exhibit 2), Trust Agreement (Exhibit 3), Promissory Note (Exhibit 4) and Collateral Assignment of Beneficial Interest (Exhibit 5). It is Appellant's position that these instruments all having been executed and delivered concurrently on July 26, 1956, collectively constituted the security for Phoenix Title and Trust Company's advance of $50,000.00 to Arthur Peabody the bankrupt. The general rule is that

> "where several instruments, executed contemporaneously or at different times pertain to the same transaction, they will be read together although they do not expressly refer to each other."
> Vol. 17A, C.J.S. Sec. 298, Separate writings, page 128. Restatement of Contracts 237C. *Clark v. Levy,* 25 Ariz. 541. 220 Pac. 232.

The foregoing is a rule of construction to determine the intent of the parties, and an examination of the documents Exhibits 2, 3, 4 and 5 show the Trust Deed was given and delivered and recorded to give notice to the world of the existence of the trust, a Collateral Assignment was given to secure the Note, and the Trust Agreement, which contained provisions providing for the sales of lots of the trust property, constituted the vehicle by which repayment of the Note and Collateral Assignment would be effected. The only purpose of the Trust Agreement was to act

as a vehicle for funding the repayment of the debt; that is obvious from its terms and the fact it was executed simultaneously with the other instruments. All four instruments should, consistent with the intentions of the parties, be regarded as part of the same transaction and construed together. By way of comparison it is notable that in *Barringer v. Lilly supra* the instruments consisted of a Trust Agreement in the nature of a Contract for the Sale of Real Estate in that one beneficiary was the seller and the other beneficiary was the buyer, a Promissory Note and a Trust Deed. If it were not for the existence of the Promissory Note in *Barringer v. Lilly* the Court undoubtedly would have determined the instruments executed were in the nature of a land purchase contract, but because of the existence of the Note, the Court held that the transaction was intended as a mortgage. Thus, the Court in *Barringer v. Lilly* in determining the nature of the transaction and the intention of the parties looked at all the instruments collectively and found

> "The fact that Tunney gave a Note for $85,000.00 and that the declaration of trust recited that it was to secure payment of the Note seemed to lead irresistibly to the conclusion that the declaration of trust was regarded as a mortgage."

The instruments used in the Peabody case were the same Trust Deed as used in *Barringer v. Lilly,* the same Promissory Note, but a declaration of trust was employed to provide for lot sales as a means of funding the repayment of the Note; the Collateral Assignment is substantially the same as the usual Mortgage in this jurisdiction so that the instruments in the instant case are more conventional as establishing a mortgage than those of *Barringer v. Lilly* where the

declaration of trust was a hybrid between a Mortgage and a Contract for the Sale of Real Estate. Accordingly, it follows that if all the instruments executed in the instant case are treated as part of the same transaction and as constituting a mortgage, the facts of this case come squarely within the rule of *Barringer v. Lilly,* wherein the Court in speaking of Sec. 969 of the Revised Code of Arizona 1928 (now 33-412(A), Arizona Revised Statutes) said:

> "This statute protects creditors and innocent purchasers against an unscrupulous or dishonest *owner of record in possession* . . . if inquiry was made by the creditors they would have actual notice of the declaration of trust else how could Owens explain away the record title in the title and trust company.
>
> "It being established that record title was in the title and trust company, it follows that all creditors were creditors with notice of the fact that Owens and his associates were not owners of the tract, at least so far as the record was concerned — which is notice to all the world."
>
> 9 Cir 96 F.2d 607 at 612-613.

Again the Court, at page 613 states:

> "In either case, the record title in the Title and Trust Company would be sufficient to put all persons on notice that Owens, Denmore and Mills did not own the property or that it was encumbered. Such a deed would then be a conveyance in the nature of a mortgage with the title in one person subject to being defeated by the performance of a condition."

It is interesting to note in the quoted portion immediately above that the Court in *Barringer v. Lilly construed the deed as constituting a mortgage* and looked to the other instruments for the establishment of the

condition the performance of which would defeat the title in the record holder. In any event, the Court construing the deed as the mortgage established the principle that the recording of the deed satisfied the recording statutes of Arizona. The above rule enunciated by the Court that the deed constituted the mortgage, even though it was a Trust Deed, is comparable to the established rule in Arizona that a deed absolute on its face given as security for a debt constituted a mortgage. *Coffin v. Green,* 21 Ariz. 54, 185 P. 361. *Rogers v. Greer,* 70 Ariz. 264, 219 P.2d 760.

The ruling of the District Court on March 29, 1963 (TR 171), can have no application if the instruments, Exhibits 2, 3, 4 and 5 are construed together to form the mortgage insofar as that ruling affirms the Referee in Bankruptcy in determining that the trust created was a passive trust, because if the instruments collectively constitute a mortgage, the duties of the Trustee in enforcing the terms of the mortgage are absolute duties which in the event of a default impose a mandatory duty of foreclosure. There can be no dispute that if the Trustee is deemed to have duties under the Collateral Assignment provisions of the trust arrangement, that the duties are active in the full sense of the phrase and the trust is not executed by the Statute of Uses.

## C. WHERE TRUST INSTRUMENTS ARE NOT CONSTRUED TOGETHER

### (1) Appellant's Position

Even if the trust instruments are not construed together, and the Trust Deed and the Trust Agreement, Exhibits 2 and 3 respectively, are construed together disregarding fully, however, the Note and Collateral Assignment, it is the position of Phoe-

nix Title and Trust Company that the Trust Deed and Trust Agreement by their terms establish active duties removing the trust from the operations of the Statute of Uses. If these two instruments create active duties effecting an equitable conversion so that the rights of the beneficiary, Peabody, are personal property, then these rights are subject to assignment for security purposes by a Collateral Assignment beyond the purview of the Arizona real property mortgage recording act (Sec. 33-412A, Arizona Revised Statutes). Under the California cases, the Trust Agreement and Trust Deed create a trust, the terms of which cannot be carried out unless the beneficiaries' interests are mere contract rights. Thus, the California Supreme Court in *Craven v. Domequez Estate,* 237 Pac. 821 at 824, stated:

> "The title insurance and trust company as trustee, therefore took an estate in the trust property adequate to the execution of the trust and as the trust was to convey an absolute title to the lands and to distribute the proceeds of all sales thereof, it was necessary for it to own and hold the absolute title to the trust property. This was clearly provided for in the instruments executed by the parties and created the trust."

And in *Wright et al. v. Security First National Bank of Los Angeles,* 95 P.2d 194, the contention was made that a subdivision land trust would not convert the beneficiaries' interest into personal property unless it were mandatory under the trust agreement for the trustees to sell all the real property in any event, and there must be no power of termination of the trust or contingency upon which any part of the land could be returned to the grantor. The Court rejected this contention, stating at page 198:

> "In Smith vs. Bank of America etc Association supra the trust agreement provided that the trust might be closed by the conveyance of any unsold portions of the property to the beneficiaries, but it further provided that the interest of each beneficiary was personal property and not an interest in the property conveyed to the trust. Although the interest of the creditor was being considered it was held that the beneficiaries had no interest in the real property."

An examination of the Smith case — *Smith v. Bank of America National Trust & Savings Assoc.*, 57 P.2d 1363 — will show that the California Supreme Court considered the importance of the language of the trust agreement providing the beneficiaries' interest would be personal property as well as the fact that the trustee might reconvey to the benefciary any unsold real property. Thus the Court stated at page 1367:

> "While it is true that words in a trust agreement to this effect do not create a conversion of real property to personal property, it throws some light on the intention of the parties to the trust agreement, as stated the intention is the criterion. Keeping this in mind, we may go to the trust agreement itself to find what burden is cast upon the trustee . . . It provides that the trustee holds the title in trust (1) to sell and convey the property; (2) to release from the lien of the indebtedness secured by it any and all lots; (3) to receive and disburse the moneys received from the sale of lots . . . (4) to sell the beneficial interest created by the trust agreement as may be necessary to satisfy defaults and reasonable expenses and trust agreements (5) and to publish the required notices therefor (6) and may close the trust 'by the sale of all property hereunder; provided, however, that in the event said trust should be closed by conveyance of said property or any

remaining unsold portions thereof to the beneficiaries or their nominees without consideration' . . ."

Comparing the Peabody Trust Agreement to the Smith agreement, following are its material provisions:

(1) "Purposes of *subdividing, platting, deeding, selling, conveying, receiving payment* . . . Trustee is . . . granted full power to do all acts necessary to accomplish the purposes . . ." ART. I. The foregoing were to be carried out by the Trustee at the beneficiaries' direction. (emphasis supplied)

(2) ". . . it is further agreed the Trustee is authorized *to dedicate* to the public use all road, alley . . . necessary for . . . The trustee is . . . authorized to . . . record . . . restrictions." ART. II (emphasis supplied)

(3) ". . . the trustee shall have the right to include the property held hereunder in the . . . Liability Policy carried by Phoenix Title and Trust Company." ART. III.

(4) All instruments . . . shall be *executed solely by* . . . Phoenix Title . . . Any *sales agreements* executed by the trustee . . ." ART. IV (emphasis supplied)

(5) ". . . all funds . . . from leasing or sale . . . *shall be paid to the trustee and thereafter disbursed by the Trustee as follows*: . . ." ART. V (emphasis supplied)

(6) ARTICLE VI provides for title policies and ARTICLE VII for accounting and "The beneficiaries shall be entitled to *monthly statements* from the Trustee . . ." ART. VII (emphasis supplied)

(7) ARTICLE IX provides *no one required to look to trustee's authority to act* and ARTICLE X provides:

"The interest of the beneficiaries in this trust is *personal* property, and the beneficiaries have not and *shall not at any time have any right, title, or interest in* . . . the property . . ., and have not and *shall not have any* . . . power *to . . . secure dissolution or termination of this trust or the partition* . . . The sole right . . . of the beneficiaries is to enforce the . . . terms of this trust . . ." ART. X (emphasis supplied)

(8) *"No assignment . . . shall be valid* . . . until . . . accepted by the trustee." ART. XII (emphasis supplied)

(9) ARTICLE XIV provides for termination of the trust on

"Conveyance of all the property by the trustee . . ., and the distribution of all the funds . . . In the event said property has not been conveyed by . . . *July 23, 1961,* the trustee *may* . . . convey the property to the Beneficiaries, and the trust shall be . . . terminated." (emphasis supplied)

In addition, the Trust Deed itself, Exhibit 2, granted the Trustee the following powers of record:

To hold, sell and convey, mortgage or pledge the trust property, to handle the said property in the same manner as though Phoenix Title and Trust Company had the property in fee simple and not as trustee. The power to plat into blocks, lots, tracts, etc., and to dedicate portions thereof as parks, streets, etc., full power to

"sell and convey the property hereby conveyed and hereafter described on such terms as the said trustee shall designate, to make, execute and deliver deeds therefor and to do all further acts . . . for the carrying out of the above purposes."

Accordingly the Peabody trust, among the beneficial duties of the Trustee, required the Trustee to *sell, execute sales agreements, and convey,* as well as numerous other duties concerning subdividing, platting, etc., and there was the duty to accept assignments of the beneficial interest. Among the protective or administrative duties of the Trustee the trust required the Trustee to make accountings, render monthly statements, receive and disburse funds, and keep the property insured for public liability. These duties go way beyond the two affirmative duties required to make a trust active under *Restatement of Trusts,* Sec. 69.

Above all, the trust was irrevocable (Article X of the Trust Agreement, Exhibit 3) until all the property was sold or until July 23, 1961, if not sold, but even in the latter case the language of the trust actually does not require the Trustee to reconvey the remaining land( although after July 23, 1961, the trust would become passive). The beneficiaries could not get the property back (Article X) since they are prohibited from partitioning or dissolving prior to July 23, 1961. *Breen v. Breen,* 103 N.E.2d 625 at page 627.

The trust is an active, irrevocable trust for a definite term imposing on the Trustee many duties but especially the *duty to convey,* and the interest of the beneficiaries is by the terms of the Trust Agreement declared to be personal property.

It is therefore clear that equitable conversion has resulted:

> *Restatement of Trusts,* § 131 Equitable Conversion.
>
> "(1) If real property is held in trust and by the terms of the trust a duty is imposed upon the trustee to sell it and hold the proceeds in trust or dis-

> tribute the proceeds, the interest of the beneficiary is personal property."

Since the *Restatement* is the law in Arizona by which the Peabody Trust Agreement's legal effect is determined —

> "We have repeatedly stated that where not bound by previous decisions of this court or legislative enactment we will follow the Restatement of Law." *Ingalls v. Neidlinger,* 216 P.2d 837, 70 Ariz. 40; *Bristor v. Cheatham,* 255 P.2d 173, 75 Ariz. 277; *Waddell v. White,* 109 P.2d 843, 56 Ariz. 525; *Rodriquez v. Terry,* 290 P.2d 173, 75 Ariz. 277 —

it is clear that the interest of the Peabodys was personal property at the time they executed the Collateral Assignment. And

> "The Statute of Uses does not execute a use or trust created upon any interest except a freehold interest in land." *Restatement of Trusts,* Sec. 70

If it is contended that because the Peabodys might eventually get the real property back equitable conversion did not occur, the Illinois Supreme Court has answered that contention as follows:

> The rule has been long and well established in this State that the form of Deed of Trust and Trust Agreement before us created a valid and subsisting trust under which the interest of the beneficiary is personal property only and not real estate. It has been repeatedly held that an agreement creating an interest in the profits or proceeds of the sale of real estate creates no interest in or lien upon the land itself. . . . It is true that under the terms of the Land Trust Agreement, Shrader, the beneficiary, had the power to direct the trustee to convey the real estate to him and thus reconvert his interests in said land trust into real estate, but until he exercised such power his in-

> terest remains personalty so long as the trust continues in effect and before such reconversion is actually accomplished."
>
> *Chicago Title and Trust Co. v. Mercantile Trust & Savings Bank.* 20 N.E.2d 992 at 995.

Continuing on page 996 the Court said:

> "It follows that the interest of Shrader, the beneficiary of the Land Trusts, being personal property, the Statute of Uses did not operate to reconvert or change the character of the estate of such beneficary from personal property to real estate. That requred an election or exercise of power by the beneficiary himself. The Statute of Uses does not operate upon personal property interests but only upon interest in real estate."

Further, if it is contended that the duties of the trust company are ministerial under the Peabody Trust Agreement, such is not significant. What is important is that there be affirmative duties, and it matters not that the Trustee's duties don't arise until the beneficiary gives an order. Thus in *Chicago Title v. Mercantile Trust supra* at page 996 the Court states:

> "Even though we assume that Shrader, the beneficiary, had the equitable title to the land, would the Statute of Uses execute the trust? The Statute would not operate because the trustee has active duties to perform under the trust agreement sufficient to remove the trust from the class which the Statute of Uses executes. Although it is repeatedly asserted in appellant's brief that the trust under consideration is one that is dry and passive because the trustee has no duties to perform, it is expressly covenanted in the trust agreement that the trustee will at the written direction of Shrader 'make deeds for, or otherwise deal with the title to said real estate' and that 'if any property remains in the trust twenty years from this

> date it shall be sold at public sale by the trustee on reasonable notice, and the proceeds of the sale shall be divided among those who are entitled thereto under this agreement'."

And:

> "If active duties are imposed it does not matter that they are merely formal or ministerial."
>
> *Gordon v. Baxter,* 127 N.E. 717, 293 Ill. 547.

Finally, it should also be noted that the Peabody Trust Agreement has a maximum 5 year term: 7/23/56 - 7/23/61, and it is universally held that:

> "c. Equitable non-freehold interest.
> Although the property held in trust by the trustee is real property, the interest of the beneficiary is personal property if it so limited in duration that it is a non-freehold interest."
>
> *Restatement of Trusts,* Sec. 130, Comment C, 90 C.J.S. Trusts, Sec. 186, p. 79.
>
> *DeHaven v. Sherman,* 22 N.E. 711, 131 Ill. 115.

(2) Authorities Cited by the District Court.

(a) The District Court's decision of March 29, 1963 (page 171 of the Record), cites *Janura v. Fancl,* 52 N.W.2d 144, and *Gallagher v. Drovers Trust & Savings Bank et al.,* 88 N.E.2d 870, in support of the proposition that the Peabody Trust, as reflected by the Deed and Trust Agreement only, Exhibits 2 and 3, is a passive trust. Both these cases involved actions for partition and in no way involved transfers for security purposes or subdivision land trusts. In *Janura* the court stated at page 145

> "The trust instrument also recited that the beneficiaries should have the management and control of the property and of the selling, vesting and han-

> dling thereof, and that the trustee would have *no duties* to perform for twenty years." (emphasis supplied)

The trust instrument in this case by its terms was inactive for the 20 year period, so that partition when sought was inevitable. Not so the Peabody trust where the Trustee had the active duties previously outlined and had, in fact, exercised those duties under the Trust Deed and Trust Agreement by making sales reducing the Note (Exhibit 4) from $50,000.00 to $42,000.00 (see paragraph 2 of Statement of the Case).

In the *Gallagher case*, in granting partition the Court stated:

> "In affirming a decree awarding partition the court held that an equitable conversion is not effected where a trust agreement attempts to create an equitable conversion but provides no definite time for the sale of the land and makes no specific provsion for termination of the trust."
>
> 88 N.E.2d 870, 873.

The Peabody trust by its own terms was terminable on July 23, 1961. (ARTICLE XIV of Exhibit 3).

(b) *Chattel Mortgage Recording Provisions Cited by the District Court.*

In the District Court's order of March 29, 1963 (TR 171), the Court declared that if the interest of the Peabodys was personal property the assignment of that interest was invalid because of failure to comply with the Chattel Mortgage recording statutes of Arizona.

The District Court in this decision ignores the notice effect of recording the Trust Deed, as announced in *Barringer v. Lilly, supra.*

However, irrespective of the notice effect of the recorded Trust Deed, an examination of the Chattel Mortgage recording statutes shows that the Arizona Chattel Mortgage recording statutes should not be construed to cover the mortgaging of intangibles. Article 4 of Chapter 6 of Arizona Revised Statutes is entitled "Chattel Mortgages" which, while not part of the statutes of Arizona, indicate the intention of the codifiers to provide mortgage procedures for tangibles (chattels). Sec. 33-751 Arizona Revised Statutes was adopted from West's Annotated Civil Code of California Sec. 2955, which provides as follows:

> "§ 2955 *Mortgageable Property*
>
> Mortgages may be made upon all growing crops, including grapes and fruit, and upon any and all kinds of personal property, except the following:
>
> 1. *Personal property not capable of manual delivery;*
> 2. Articles of wearing apparel and personal adornment;
> 3. The stock in trade of a merchant.
>
> Provided, however, that any nonprofit cooperative association with or without capital stock is not to be deemed a merchant within the meaning of this section." (emphasis supplied)
>
> West's Annotated California Codes Vol. 11, p. 266.

The italicized portions of the above statute were omitted when adopted by Arizona. Unless the omitted portion of the California statute is read into the Arizona statute, it follows that all transactions involving choses in action such as the pledging and escrow of stocks, bonds, and accounts receivable, are violative of the present Arizona statutes. Logically a Chattel Mortgage recording statute which is predicated on the

mortgaged chattel remaining in the possession of the debtor cannot be interpreted to cover intangibles. Security devices should be consistent with the kind of property to which the security attaches, which may or not (e.g. pledge) require the recording of a legal instrument. Though the statutory definition of personal property in Arizona includes intangibles, the chattel mortgaging statute should not be literally construed to void customary security devices involving intangibles, such as escrows, pledges, etc., whch do not require recording, nor should it be applied in this case where the intangible property is in the hands of the mortgagee.

(3) The Effect of Record Title in Phoenix Title and Trust Company.

It is Appellant's position that even if the Statute of Uses were deemed applicable and even if the Trust Deed, Trust Agreement, Note, and Collateral Assignment are not construed together, recording statutes are intended to protect bona fide purchasers and if the lien of Phoenix Title and Trust Company is valid against bona fide purchasers, it is valid for purposes of determining its lien under the Bankruptcy Act. Thus, in *Barringer v. Lilly,* the Court on page 614 stated:

> "We have already shown that the creditors are not creditors without notice and even though the declaration of trust may be void as to them there is no explaining away the record title in the name of Appellant title and trust company."

Thus, in *David v. Kliendienst,* 64 Ariz. 251 at page 258, 169 Pac. 2d 78, the Court stated:

> "The law seems to be settled that a person who fails to exercise due diligence to avail himself of information which is within his reach is not a

> bona fide purchaser. . . . Thus a purchaser who has brought to his attention circumstances which should have put him on inquiry which if pursued with due diligence would have led to knowledge of an adverse interest in the property is not a bona fide purchaser."

And in *Barringer v. Lilly,* 96 Fed. 2d 607 at page 613,

> ". . . The record title in the title and trust company would be sufficient to put all persons on notice that Owens, Denmore and Mills did not own the property or that it was encumbered."

In *Maricopa Utilities Company v. Kline,* 60 Ariz. 209 at page 214; 134 P.2d 156, the Court stated:

> "Notice of facts and circumstances which would put a man of ordinary prudence and intelligence on inquiry is equivalent to knowledge of all of the facts a reasonable diligent inquiry would disclose."

And:

> "Notice of the existence of a trust is by all the authorities held to impose the duty of inquiry as to its character and limitations and whatever is sufficient to put a person of ordinary prudence upon inquiry is constructive notice of everything to which the inquiry might have led."

*Shaw v. Spencer,* 100 Mass. 382 at 389.

The transcript is vacant of any evidence of any creditor of the bankrupt Arthur Peabody making inquiry of the trust of which notice existed pursuant to the recorded Trust Deed. Regardless of the application of the doctrines of the Statute of Uses, the construction of the trust instruments without reference to the Note and Collateral Assignment, the recording of the Trust Deed cannot be held to be an idle act, for

as the Court said in *Barringer v. Lilly,* 96 Fed. 2d 607 at page 612,

> "To hold as appellee Lilly urges that the record title of the title and trust company was meaningless would be to place land owners everywhere at the mercy of their tenants."

That the recording of the Trust Deed alone was sufficient record notice of Phoenix Title and Trust's lien is evident in the Arizona statute defining mortgages where a transfer in trust for security purposes is excepted:

> "§ 33-702 Mortgage defined; pledge distinguished, admissibility of proof that transfer is a mortgage.
>
> Every transfer of an interest in property, *other than in trust,* made only as a security for the performance of another act is a mortgage, except . . ." (emphasis supplied)

## CONCLUSION

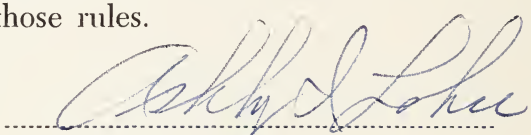
In view of the authorities, facts and argument set forth above, Appellant submits (1) that the District Court erred in not construing the trust instruments Exhibits 2, 3, 4 and 5 together as constituting a valid mortgage under the doctrine of *Barringer v. Lilly, supra;* (2) alternatively that the District Court erred in not finding the Trust Deed and Trust Agreement (Exhibits 2 and 3) created an active trust; and (3) alternatively that the District Court erred in disregarding the legal effect of the recording of the Trust Deed (Exhibit 2) as set forth in *Barringer v. Lilly, supra.*

*Respectfully submitted,*

LOHSE, DONAHUE & BLOOM

By .....
Attorneys for Appellant

I certify that, in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.



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